

Statutory basis for rate recovery of the cost of environmental controls by electric utilities in Kentucky

April 2012

KENTUCKY PUBLIC SERVICE COMMISSION

Two applicable statutory mechanisms:

- Principal mechanism: Environmental surcharge KRS 278.183
- Also: certificate of public convenience and necessity (CPCN) KRS 278.020 (1)

Operation of both mechanisms is determined by statute, regulation and legal precedent

Rate recovery of the cost of environmental controls for coal-fired power plants owned by electric utilities in Kentucky is governed by the Environmental Surcharge Mechanism (ESM)

The environmental surcharge:

- Adopted by Kentucky General Assembly in 1992 – effective January 1, 1993
- Principally a response to federal Clean Air Act Amendments of 1990, which set limits on sulfur dioxide and nitrogen oxide emissions from coal-fired power plants
- Process is similar to rate case – allows intervenors, discovery, hearings, etc.

The environmental surcharge:

Section 1

... a utility shall be entitled to the current recovery of its costs of complying with the Federal Clean Air Act as amended and those federal, state, or local environmental requirements which apply to coal combustion wastes and by-products from facilities utilized for production of energy from coal in accordance with the utility's compliance plan...

The environmental surcharge:

Section 1 (cont.)

... These costs shall include a reasonable return on construction and other capital expenditures and reasonable operating expenses for any plant, equipment, property, facility, or other action to be used to comply with applicable environmental requirements set forth in this section.

The environmental surcharge:

Section 1 (cont.)

Operating expenses include all costs of operating and maintaining environmental facilities, income taxes, property taxes, other applicable taxes, and depreciation expenses as these expenses relate to compliance with the environmental requirements set forth in this section.

The environmental surcharge:

Sections 2-5

- Set the process by which utilities apply for an environmental surcharge and the PSC's consideration thereof
- Process is similar to ratemaking in its consideration of reasonable costs and rates of return
- Surcharge appears as separate line item in the bill, either as an additional increment or as a credit
- At two-year intervals, PSC may, as appropriate, roll environmental surcharges into base rates

**Environmental surcharge cases
may include an Environmental
Compliance Plan (ECP) and one or
more applications for permission
to construct related facilities**

The environmental surcharge:

Key points:

- Presumption of compliance with environmental mandates
- Presumption of recovery of costs of complying with environmental mandates
- Utility entitled to rate of return on environmental investments
- Reasonability standard applies to compliance plan and rate surcharge
- If compliance plan include construction of facilities, utilities may file for CPCN as part of compliance plan

Prior to construction of any major facility, including an electric generating facility, a utility must apply for a certificate of public convenience and necessity (CPCN)

The review process:

- Principal review process: Certificate of public convenience and necessity (CPCN)
KRS 278.020 (1)
- Burden of proof lies with the applicant

Application of the CPCN process is determined by statute, regulation and legal precedent

The CPCN process:

Key points:

- Statute (KRS 278.020) is general – parameters of PSC decision have evolved over time through legal precedents
- Applicant must show a need for proposed facility – in ESM cases, this means showing the facility will result in compliance with environmental requirements
- Utility must show it has considered reasonable options, such as:
 - various types of new facilities
 - purchase of generating capacity or off-system power
 - demand-reduction measures

The CPCN process:

Key points:

- Wasteful duplication is not allowed – a utility may not overbuild or incur unnecessary costs
- “Least cost” principle flows from absence of wasteful duplication
 - Least cost not just construction or acquisition cost
 - Long-term costs also considered
 - PSC seeks least-cost reasonable option
- Grant of a CPCN leads to a presumption of future cost recovery

Kentucky Power Case

Case 2011-00401

- Case 2011-00401 – Kentucky Power's environmental compliance plan (ECP)
- ECP involved decisions on whether to upgrade, replace or retire existing generating facilities
- Upgrade – Big Sandy Unit #2 – 800 MW
- Retire – Big Sandy Unit #1 – 278 MW
- Total cost: \$1.07 billion (attributable to Kentucky Power)

Kentucky Power Case 2011-00401

Proposed in Kentucky:

\$940 million in environmental projects

- Scrubber on the larger unit at Big Sandy
- Kentucky Power is under federal consent degree to either construct scrubber by end of 2015 or stop burning coal at the plant

Projected rate impacts

- 30 % in 2016
- \$31/month for 1,000 kwh per month customer
- Average monthly bill would increase from \$98 to \$129

Kentucky Power Case

Case 2011-00401

NEXT STEPS

- Public comment meetings this week
- Evidentiary hearing – April 30 – 10 am EDT
 - PSC offices – 211 Sower Boulevard, Frankfort
 - Open to public
 - Streamed live at psc.ky.gov
- Post-hearing filings
- PSC decision

FOR MORE INFORMATION

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QUESTIONS